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Supreme Court of the United States

OCTOBER TERM, 1960

No.

GEORGE K. HEEBNER, JR. and RUTH S. HEEBNER,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered in the above cause on June 23, 1960 (App. p. 13a)* affirming a decision of the Tax Court of the United States (P.A. 128a).

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*The references to the record before the Court of Appeals consist of the appendix to the brief filed by petitioners (P.A.). Citations to (App.) refer to the appendix to this petition.

OPINIONS BELOW

The opinion of the Tax Court is reported at 32 T.C. 1162. The opinion of the Court of Appeals is reported at 280 F.2d 228.

JURISDICTION

The judgment of the Court of Appeals for the Third Circuit was entered on June 23, 1960 (App. p. 13a). A timely petition for rehearing was denied on July 29, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

Internal Revenue Code of 1939, as amended. Section 117, Capital Gains and Losses.

> "(a) *Definitions.*—As used in this chapter—
>
> "(1) Capital Assets.—The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—
>
> "(A) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business; . . ."

QUESTION PRESENTED

Does the statutory phrase "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" as applied to the construction industry, comprehend a single sale of land and a building and the assignment of a lease covering occupancy of the bulding solely because the vendor is

engaged in the business of providing construction services?

STATEMENT

In September 1951, petitioner* purchased a parcel of ground and agreed to lease to the Nash-Kelvinator Sales Corporation a building that was to be constructed on the land by a corporation of which petitioner was president and controlling stockholder. Subsequently, because of a Federal Reserve Board Regulation which precluded satisfactory financing, petitioner in February 1953 conveyed the land and the building to the Prudential Insurance Company of America together with an assignment of the Nash-Kelvinator lease covering the building.

This was the first and only time that petitioner had ever sold either a building or a parcel of land or a combination of the two (P.A. 88a). Nor had petitioner's construction corporation, which built the building, ever purchased or sold any land or buildings or combinations thereof (P.A. 69a). More important from the point of view of the Federal tax laws, the tax on the profit realized from construction of the building was paid by the corporation at ordinary income tax rates. The profit on the sale to Prudential was attributable solely to the value of the land and the lease agreement. The profit realized on the construction of the building was not, and is not, in issue.

The court below held that the gain realized by petitioner on the sale to Prudential as a matter of law

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*The word petitioner refers to George K. Heebner, Jr. Ruth S. Heebner is a party to this action on the basis of Mr. and Mrs. Heebner's having filed a joint Federal income tax return.

resulted in ordinary income on the ground that the property was held by petitioner primarily for sale to customers in the ordinary course of his business of performing services in the construction industry. The court found—what has never been disputed—that petitioner's business was that of a "package builder." Both common knowledge and the record show that a "package builder" is one who is hired to build a building for another, to arrange for architectural services and to assist the owner in obtaining desirable financing (P.A. 69a). In other words, a "package builder" is one who performs the entire package of services necessary to construct a building for the owner. The profitable performance of such services results in ordinary income. A "package builder" neither buys nor sells the land on which he builds. He does not own the building he constructs, nor does he enter into lease agreements covering the occupancy of the building. The court nevertheless concluded that the property sold to Prudential was held by petitioner primarily for sale to customers in the ordinary course of his trade or business simply because he was engaged in the business of performing construction services.

The court below stated that this construction of the statutory phrase was dictated by the opinion of this Court in *Corn Products Refining Company* v. *Commissioner*, 350 U.S. 46.

REASONS FOR GRANTING THE WRIT

The decision of the court below misapplied the opinion of this Court in *Corn Products Refining Company* v. *Commissioner*, *supra*, and in so doing erroneously construed one of the most important

provisions of the Federal tax laws so as to deny capital gains treatment to the petitioner contrary to the legal principles applied to taxpayers in other industries.

The statutory basis of this cause had its origin in 1921 when Congress limited the rate of taxation upon gain derived from the sale of "capital assets," thus giving rise to a separate category of taxable income. The Revenue Act of 1921, Sec. 206, 42 Stat. 232, 233, defined "capital assets" to mean "property acquired and held by the taxpayer for profit or investment" and then proceeded to exclude such categories of property as inventory items, stock in trade and property held for personal consumption. This statutory framework has been generally continued. Thus, Section 117 (a) of the Internal Revenue Code of 1939 defined "capital assets" by referring in the first instance to "property held by the taxpayer (whether or not connected with his trade or business)" after which the statute provides four specific categories of property which are excluded from the definition of "capital assets." The most important of these and the one here in issue is that of "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business."

In the instant case, the court below denied the capital gains treatment accorded by the statute on the ground that the property sold by petitioner was held by him primarily for sale to customers in the ordinary course of his business despite the conceded fact that petitioner had never before and has not since sold such property or held such property for sale. The court found that its conclusion was dictated by the

opinion of this Court in *Corn Products Refining Company v. Commissioner, supra.*

In *Corn Products* the Court was called upon to determine whether sales of corn futures by a manufacturer of various corn products gave rise to capital gain. The Corn Products Refining Company manufactured starch and sugar. As protection against rising corn prices, the company purchased corn futures at harvest time and took delivery under these contracts in the event that spot corn prices rose. It sold the remainder of the futures in early summer if no price rise was imminent. The Court held that the gain on the sale of the futures was ordinary income. In reaching this conclusion, the Court stated:

> "We find nothing in this record to support the contention that Corn Products' futures activity was separate and apart from its manufacturing operation. . . . Under these facts it is difficult to imagine a program more closely geared to a company's manufacturing enterprise or more important to its successful operation."
>
> ". . . Admittedly, petitioner's corn futures do not come within the literal language of the exclusions set out in that section [§ 117]. They were not stock in trade, actual inventory, property held for sale to customers or depreciable property used in a trade or business. But the capital-asset provision of § 117 must not be so broadly applied as to defeat rather than further the purpose of Congress. . . . Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. . . ." (pp. 50-51)

The Court was thus concerned with profits arising from the everyday operation of a business. The Court

was *not* concerned with whether property was held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. In fact, the Court was very careful to point out that the corn futures did not come within any statutory exclusion. To put it most simply, *Corn Products* deals with only one issue—property regularly bought and sold in the everyday operation of a business but not sold to customers.

The court below, however, misconstrued *Corn Products* and in so doing carved out from the statute a broad class of property, the sale or exchange of which has traditionally been held to give rise to capital gain. This can be seen most clearly from the undisputed facts of the case. Petitioner's trade or business was that of a builder. He had never constructed buildings for sale nor bought or sold real estate (P.A. 69a, 88a). The profit on the construction of the building sold to Prudential was taxed in full to petitioner's corporation, and it was only the construction of the building which was in any way related to petitioner's trade or business. The land and lease which actually produced the profit were in no way connected with petitioner's trade or business.

In holding that the property sold to Prudential was held by petitioner primarily for sale to customers simply because petitioner is in the building business, the court below confused the building with the business. If petitioner had been in some other business, or one of the professions, there is no question but that he would have been entitled to capital gain on this transaction. As a builder, petitioner was

denied capital gain although no building services and no builder's profit were involved. If the decision of the court below is allowed to stand, then persons in the building industry will be denied capital gain opportunities not involving a builder's profit. This result conflicts with all of the statutory gloss.

The courts have consistently permitted capital gains treatment in other industries even where the property sold is identical with that held by the taxpayer for sale in the ordinary course of his trade or business. A good example of this is the allowance of capital gains treatment on the sale of stocks and bonds by securities dealers. *Vaughn* v. *Commissioner*, 85 F.2d 497 (2d Cir. 1936), *cert. denied* 299 U.S. 606. (The requirements as to identification of securities are now codified as part of the Internal Revenue Code of 1954, see Section 1236.) A further example of this policy is reflected in *United States* v. *Bondurant*, 245 F.2d 265 (6th Cir. 1957), where a taxpayer in the business of selling cotton, purchased bales of cotton, identified them, and placed them in a public warehouse. The court held that the profit realized on the sale of the cotton was taxable as capital gain. Registered real estate brokers have also been permitted to treat profit from the sales of real property as capital gain. *Thomas* v. *Commissioner*, 254 F.2d 233 (5th Cir. 1958).

The automobile industry has given rise to much litigation in this area. The courts have frequently held that vehicles used for rental purposes and regularly disposed of by the taxpayer after a certain period of time or extent of use do not constitute property held by the taxpayer for sale to customers in the ordinary course of his trade or business.

Philber Equipment Corp. v. *Commissioner*, 237 F.2d 129 (3d Cir. 1956). The courts have reached this same conclusion in connection with the sale by automobile dealers of "company cars". *Duval Motor Co.* v. *Commissioner*, 264 F.2d 548 (5th Cir. 1959). Moreover, in *Massey Motors, Inc.* v. *United States*, 364 U.S. 92, this Court took it as admitted that where a new car dealer annually sold every car that he had either rented or used as a company car, such sales were of "depreciable assets rather than ordinary stock in trade" which for tax purposes resulted in capital gain.

Indeed, the statute simply does not permit the courts to treat as capital transactions sales of property of the same type regularly sold in the taxpayer's trade or business, and deny such treatment to a member of the construction industry when he makes a single isolated sale of property in no way related to his trade or business. Certainly the building industry should not be singled out for tax treatment less favorable than that accorded taxpayers in other industries. Neither the statute nor any decided case supports what the court below has done. The opinion of this Court in *Corn Products Refining Company* v. *Commissioner, supra*, has received varying interpretations it is true but until the opinion below, no one had ventured to say that *Corn Products* required that whenever a taxpayer sells property unrelated to his business, he must as a matter of law, be regarded as holding that property "primarily for sale" to customers in the ordinary course of his business.

The decision of the court thus conflicts with the statute as well as the decisions of this Court and lower courts. The building industry, without legal

justification, has been placed in a capital gain position inferior to that enjoyed by taxpayers in other industries. The Court should act to correct the distortion of the plain meaning of this most important Federal revenue provision and to insure that the tax laws are applied uniformly.

CONCLUSION

For the foregoing reasons this petition for a Writ of certiorari should be granted.

Respectfully submitted.

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